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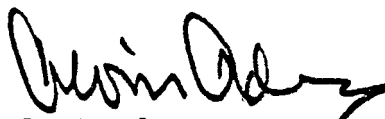
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SUBJECT: Report of European Consultations on Yamal Pipeline Alternatives

Attached is a draft summary report of consultations that an interagency team led by Under Secretary Rashish held in Europe concerning the Soviet-Western European natural gas pipeline. Comments on this report are welcomed.

NSC review completed - may be declassified in part

  
L. Paul Bremer, III  
Executive Secretary

Attachment:

Draft Summary Report

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State Dept. review  
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Summary Report of Consultations with Europeans on the  
Soviet-Western European Natural Gas Pipeline

Summary

In response to President Reagan's commitment at the Ottawa Summit Under Secretary of State for Economic Affairs Rashish led an interagency team to Europe over the past two weeks to discuss alternatives to the Soviet gas. The US delegation -- composed of representatives from State, Commerce, DOE, DOD and NSC -- met with eight countries, including all the participants in the pipeline deal, as well as key European natural gas producers -- who might be called on to expedite the rate of their gas exports or at a minimum increase their capacity to provide a European gas cushion in case of disruption in Soviet gas deliveries. One part of the delegation also had meetings with high level Nigerians and key industry representatives to discuss how Nigeria might revitalize its Bonny LNG project. The major conclusions of the consultations are as follows:

1. The trip allowed an opportunity for the US and Europeans to clarify their positions and to engage in a frank discussion of mutual concerns. Strong US protests about the security and economic viability of the pipeline deal generally met with the response that our allies need the gas and are preparing measures to guard against a possible gas disruption of Soviet supplies. Of particular benefit to the Germans is the support which will be given to key depressed industries and much needed employment. While this may be a somewhat counterfeit reason, it clearly weighs heavily in their calculations as do other benefits which accrue from positive East-West relations, including a possibly more positive Soviet view towards detente and reunification.

2. We still have misgivings about the viability of the European safety net in case of gas disruption. In addition, we are not convinced the pipeline is an economically sound investment, nor is it certain that the Soviets have the equipment and management skills necessary to construct and operate the pipeline on a reliable basis.

3. Although we had no expectation of derailing the German-USSR pipeline negotiations, we had hoped that the Europeans could be convinced to delay their final decision for a few months. Although we did not achieve this objective, we received more encouragement than we had expected in other areas:

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- (i) Our mere presence apparently helped the Europeans negotiate a better price.
- (ii) At our urging, German Economics Minister Lambsdorff agreed to try to limit the fanfare associated with the completion of the pipeline, especially if this occurs during the Brezhnev visit to Bonn on the 23rd of November.
- (iii) We had a marginal influence on the French, who were more sympathetic to our security concerns and who had less to lose in the way of overall economic gain (e.g., exports, jobs) should the pipeline be blocked. They may choose to delay final signing of the contracts for a few months in response to our concerns.
- (iv) While it appears that the first strand of the pipeline will be built, the US team was successful in getting the Europeans to rethink the need for further dependence on Soviet gas. Norwegian and Dutch gas, coupled with gas imports from Nigeria and Algeria and US coal, could together eliminate the need for further European acquisition of Soviet gas. The Europeans, especially the Germans, appear keen to continue discussions with the US on alternatives.
- (v) We raised our concern about the vulnerability of European customers to disruptions. While each country described its plans for such contingencies, it was obvious that little European-wide planning had been done. In this respect, we hope to give impetus to the European Commission in their effort to address security of European gas supply.
- (vi) At our urging, the Executive Director of the IEA, Ulf Lantzke agreed and the Governing Board later concurred, that the IEA would prepare an indepth study on natural gas prospects and related issues of security against the background of the evolving world energy situation for consideration at next June's IEA Ministerial meeting.
- (vii) A high level delegation from Nigeria met with us in Paris to discuss ways in which the Bonny LNG project could be revitalized. While the prospects for early completion are still remote, the Nigerians now appear ready to be more flexible and at our urging have agreed to reopen discussions with operating companies and potential customers.

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4. In light of our discussions on the pipeline, serious attention must now be given to preparing the President for his decision on oil and gas export controls. The pipeline is the first major test of the policy. Therefore, the options under consideration must accurately reflect the reality of the situation. We need to fold in the experience gained on this trip into the options paper now being prepared.

5. In summary, this trip provided an opportunity to initiate a broad, hard-hitting US-European discussion of Western energy security. If managed and supported properly, this dialogue could lead to closer cooperation and coordination of energy plans and objectives. While we have discussed security issues relating to oil, there has been reluctance in the past to do the same for gas. Yet because of the potential for greater gas use and because it is characteristically different from oil, it is essential that the subject of energy security, as it relates to gas, be fully addressed.

#### US Concerns

The US team presented its view that the pipeline presents a security threat to Western Europe and that there are more attractive alternatives from an economic and security standpoint. Although the quantities of Soviet gas as a percentage of total energy consumption are only about 5%, some sectors and some regions would be particularly vulnerable to disruptions. We explained that in light of the improved world energy outlook and declining European gas consumption, there was less need for the Soviet gas and thus the economics of the pipeline were becoming more uncertain. By waiting the Europeans may put themselves in a better negotiating position, especially with regards to price.

The US team presented a number of alternatives to the Soviet gas:

- Increasing imports of LNG from Nigeria appear more plausible, yet obstacles still must be overcome if the Bonny LNG project is to be revitalized.\*

\* We met with a high level Nigeria delegation. At the conclusion of the meeting, they indicated that they would reinvigorate their effort to negotiate more favorable terms with both companies who are developing the LNG infrastructure and potential customers. Completion of the Bonny project would provide about half of the gas flow of the Soviet pipeline. Despite encouraging signs it must be recognized that this project has been negotiated for over seventeen years and prospects for a quick agreement seem remote.

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- Norway has significant, yet untapped natural gas reserves which could replace the need for Soviet gas. It is difficult to say how the political constraints to production expansion will change with the new government.
- Long-haul LNG will not be competitive in US markets, thus greater quantities of gas will be available for European markets from Algeria and elsewhere.
- Coal exports from the United States could be accelerated with the US Government playing an important role in removing market impediments, thus allowing for a freer flow of coal. There was very keen interest among the Europeans in US progress in this area.

In addition to discussing alternatives, the US team explored the viability of a planned safety net intended to protect European countries in case of gas disruption. While individual countries had addressed this concern, it was our view that insufficient European-wide planning had been done to date.

We also noted that the US is incurring significant expenditure to build up the defense and security of the Middle East for the benefit of all oil importing countries. Stability in the Middle East is a high Administration priority. US oil dependence, however, is expected to diminish over time. Completion of the European-Soviet Union gas pipeline deal at this time could provoke widespread criticism by the public and Congress -- and raise the broader issue of the US role in the alliance. In private discussions with key Europeans, Under Secretary Rashish emphasized that there was a growing sense of disquiet over the pipeline in the United States. He explained that he had been asked to testify before several Congressional committees and he needed assurances that the Europeans were seriously considering security aspects.

European Response

The Europeans responded by calling attention to the economic attractiveness of the Soviet gas -- which will probably be priced well below recent European contracts. They contended that given their high dependence on Middle Eastern oil, the Soviet gas offers an important opportunity to diversify their energy options and stretch out or even shut in indigenous reserves. Europeans were interested in alternatives -- not instead of, but in addition to, the Soviet gas.

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Of obvious benefit to the Europeans, and the Germans in particular, is the support which will be given to key depressed industries and the boost to employment. It appeared that these concerns were as important to the Germans as the energy benefits. Although it was not explicitly acknowledged, the Germans probably also view the pipeline deal as a means to further detente and to improve the chances of eventual reunification.

Each country had examined the issue of security and each had more or less decided that Dutch natural gas could be substituted on relatively short notice in case of emergency. Some additional storage capacity was being considered, although gas storage is more expensive and more technically difficult than oil storage.

Lastly, the Europeans called attention to the late arrival of the US presentation -- time was running out and it was too late to stop the final negotiations -- the only outstanding issue being price. The Germans expected to sign the contract just before or during Brezhnev's visit to Bonn November 23rd.

We pressed the Germans hard not to widely celebrate the completion of the pipeline negotiations. Economic Minister Lambsdorff agreed that a low key approach would be best, but could not promise the result we wanted; he said the Soviets like to have toasts before the cameras.

The French were more sensitive to US concerns over security. While they also appear set to go through with the pipeline deal, they may have been persuaded more than the Germans to delay final consideration for a few months. The differing attitudes between the French and the Germans illustrate that there is not a totally common view among the major participating countries toward the pipeline deal. All welcome the opportunity to diversify their energy sources, but beyond this basic objective, motivations and degree of commitment differ.

#### Follow-up on Alternatives and Safety Net

The US team successfully pressed the Europeans to address our concerns and to agree to follow-up consultations on (1) accelerating energy alternatives and (2) security aspects of natural gas, including establishment of an appropriate European natural gas safety net. The fact that we have such considerable influence in the area of security and energy policy at home gives us credibility and a means to be helpful to others.

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Our discussion of alternatives has encouraged European countries to rethink the need for further gas than that presently being negotiated. Overall dependence on Soviet gas need not increase above that envisioned with completion of the first strand of the pipeline. In fact it can decrease if the alternatives which we believe are available can be brought on stream during the next ten years.

An essential element of our follow-up will be to break the log jam which has occurred over the past decade in realizing greater European gas production. This will require further bilateral consultations with the Norwegians, in particular. Several other European spokesmen admitted that only the US could hope to change the direction of Norwegian thinking on oil and gas production. In addition, we will have to follow-up discussions with the Dutch -- who have a dual responsibility -- first to continue supplying gas to European markets and secondly to provide surge capacity to be used in times of emergency.

We will also want to look more closely at the rate at which US coal exports can be accelerated. In these efforts, it will be important not to overcommit the US Government, especially in areas which would not be appropriate for the Government to take part. A good example of positive US action is the Bonny project discussions we have had with the Nigerians. In this case, we are acting as a catalyst to get that project revitalized, but not going beyond.

Our first inspection of the planned European safety net shows that it is weak and almost entirely dependent on Dutch gas. There are a number of areas where we might push the Europeans in the next round of consultations. These include (1) installation of storage facilities and an increase in oil and gas stocks, (2) encouragement of dual-fired capacity among large users, (3) greater integration of the European gas grid, (4) promotion of policies to sell pipeline gas only on an interruptible contract basis, (5) consideration of contingency plans to be used in case of gas disruption, and (6) discussion of means to increase surge capacity to be used in times of emergency, especially in the Netherlands.

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The follow-up to these discussions will take place in three distinct ways. First, we will continue to have bilateral discussions with the French, Germans, Italians, Dutch, UK and Norwegians. Secondly, at US urging, the International Energy Agency will prepare an indepth analysis of natural gas prospects and related security issues within the broader evolving world energy situation. Conclusions and recommendations for action will be prepared in time for the next IEA Ministerial meeting, now tentatively scheduled for next May/June. Thirdly, we will engage in consultations with the European Commission on the issue of the European safety net with the hope that this will give added impetus to the work of the EC in this area. These issues will initially be raised at the high level EC-US consultations scheduled for November 19-20. IEA Executive Director Lantzke and Commissioner Davignon were both encouraged by the active role of the United States. They said that this offered a new opportunity for strengthening Western energy security.

Oil and Gas Controls and the Siberian Pipeline

The President will soon have to make his decision on oil and gas controls. The Soviet-West European pipeline will be the first major test case of this policy. The experience of this trip should be considered in further revisions so that the President can make a choice which conforms to the reality of the situation.

We touched on the issue of export controls on oil and gas equipment and technology with the British. Even the mere mention of the idea received a cool reception. The UK Government supports its companies in their seeking of contracts with the Soviets viewing this as an opportunity to revitalize some of their depressed industries and to provide much needed employment. They cautioned us against taking action which would unduly complicate other areas of mutual concern.

A basic problem confronting the US and Europeans -- and one which is most evident in the pipeline experience -- is the need to establish a sensible Allied strategy towards East-West trade. In making political judgements on East-West economic issues we may have to take a more holistic approach, taking account of real world complexities. What is our basic objective towards enhancing Soviet Union oil and gas development? Do we want to help the Soviet Union with loans, which would allow them to use their own capital to continue military purchases?

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European views on these issues differ from our own. The Europeans see many economic and political benefits from East-West trade. They view Soviet development of oil and gas as very positive and view their own role in that as beneficial to both sides. It is not surprising that they would view US action to embargo key parts of the compressors as harmful to overall Western interests. They argue that it will not be the Soviets who will in the first instance be harmed by an embargo, but rather it will be US suppliers and European licensees who will be directly affected.

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